Supreme Court, U.S.
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No. ____

# In the Supreme Court of the United States

PACIFIC SHORES DEVELOPMENT, LLC,
*Petitioner*,

v.

AT HOME CORPORATION, INC.,
*Respondent*.

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit**

## PETITION FOR WRIT OF CERTIORARI

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## QUESTION PRESENTED

Section 365(d)(3) of the Bankruptcy Code provides, "The trustee shall timely perform all the obligations of the debtor ... arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title." One such obligation is the obligation to pay rent. The question presented is:

Do the equitable powers of a bankruptcy court allow the court to excuse the trustee from the obligation to pay rent which came due from and after the order for relief by ordering rejection of a lease retroactive to the date the lease rejection motion was filed, where the tenant/debtor retained possession of the premises until entry of the order, and the landlord was deprived of possession by the automatic stay until entry of the order?

## RULE 29.6 STATEMENT

Pacific Shores Development, LLC is a limited liability company organized and existing under the laws of Delaware, and has its principal office c/o Jay Paul Company, 350 California Street, Suite 1905, San Francisco, California 94104. Pacific Shores Development, LLC owns Pacific Shores Center, Redwood City, California, a multi-building office complex. It was the lessor under the leases with Respondent At Home Corporation that are the subject of this appeal. Pacific Shores Development, LLC has two members: Technology Land, LLC, a California limited liability company, and WDLJ Pacific Shores Associates, LLC, a Delaware limited liability company. No publicly held corporation owns 10% or more of Pacific Shores Development, LLC.

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## PETITION FOR WRIT OF CERTIORARI

Petitioner Pacific Shores Development LLC respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit (App., *infra*, 3a-24a) is published at 392 F.3d 1064 (9th Cir. 2004). A petition for rehearing and rehearing en banc was denied without opinion in an unpublished order filed on February 15, 2005. (App., *infra*, 1a-2a.)

The opinion of the United States District Court for the Northern District of California (App., *infra*, 25a-41a) is published at 292 B.R. 195 (N.D. Cal. 2003).

The decision of the United States Bankruptcy Court for the Northern District of California (App., *infra*, 42a-45a) is unpublished.

## JURISDICTION

The United States Court of Appeals for the Ninth Circuit issued its opinion on December 28, 2004 (App., *infra*, 3a-24a) and filed its order denying rehearing on February 15, 2005 (App., *infra*, 1a-2a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

## RELEVANT STATUTORY PROVISIONS

Section 365(d)(3) of the Bankruptcy Code provides, "The trustee shall timely perform all the obligations of the debtor

... arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title." (App., *infra*, 46a-47a.) Section 105(a) of the Bankruptcy Code provides that a bankruptcy court "may issue any order ... necessary or appropriate to carry out" the provisions of the Bankruptcy Code. (App., *infra*, 46a.)

## STATEMENT OF THE CASE

Respondent At Home Corporation ("At Home") was engaged in the delivery of broadband network services. (ER 5.)[1] In February 2000, At Home entered into two leases (the "Pacific Shores Leases") with Petitioner Pacific Shores Development, LLC ("Pacific Shores") for two office buildings (Buildings 7 and 8) (the "Pacific Shores Premises") at the Pacific Shores Center in Redwood City, California. (ER 16.)

Months before filing for bankruptcy protection, At Home "engaged in a comprehensive review of all [its] real property lease obligations, and determined that the Leases [which were the subject of the Lease Rejection Motion (including the Pacific Shores Leases)] were of little or no value or were substantially unused by [ ] Debtor[ ]." (ER 8-9, 27.)

Prior to filing its bankruptcy petition, At Home "delivered surrender notices" to all of the landlords whose leases it did not intend to retain, *except for Pacific Shores*. (ER 84-85, 89.) At Home did not inform Pacific Shores, before At Home filed its bankruptcy petition, of its intent to surrender the

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[1] "E.R." refers to the Excerpts of Record filed in the Ninth Circuit.

Pacific Shores Leases. (ER 84-85, 87-89.) Indeed, At Home admitted that it made deliberate decision not to surrender the Pacific Shores Premises to Pacific Shores prior to filing for bankruptcy because At Home did not want Pacific Shores to exercise the remedies that would have been available to Pacific Shores had At Home done so. (ER 84-85, 89.) At Home wanted to avail itself of the automatic stay, which would take effect upon filing its bankruptcy petition. *Id.*

At Home filed its voluntary petition under Chapter 11 of the Bankruptcy Code on September 28, 2001. (ER 4.)

Concurrent with the filing of its petition, At Home filed a number of "emergency motions," including At Home's Emergency Motion for Order Pursuant to 11 U.S.C. § 365(a) Authorizing Rejection of Unexpired Leases of Nonresidential Real Property ("Lease Rejection Motion"). (ER 4.) The Lease Rejection Motion sought an order rejecting certain unexpired leases of nonresidential real property, including the Pacific Shores Leases, effective retroactively to the date of the Lease Rejection Motion. (ER 4, 11.) The Omnibus Declaration of Steven Bloom, filed in support of the Lease Rejection Motion, stated that "The Debtors have either vacated, and in some instances never occupied, the non-residential real property conveyed by the Leases." (ER 19, 27-28.) No evidence was submitted that At Home did not have legal possession and control of the Pacific Shores Premises. The Lease Rejection Motion did not represent it would not be withdrawn. At Home did not seek or obtain a stipulation from Pacific Shores or the United States Trustee that the Pacific Shores Leases be rejected. (ER 83-84, 93-94.)

On October 1, 2001, the Bankruptcy Court held a hearing on certain of At Home's first day emergency motions. (ER

30-33, 35-37.) At Home's Lease Rejection Motion was not one of the emergency motions heard on October 1, 2001. (ER 35-37.) Pursuant to At Home's request during the October 1st hearing, the Bankruptcy Court scheduled a hearing on At Home's Lease Rejection Motion for October 9, 2001. (ER 36-37.) On October 2, 2001, At Home served notice that the Lease Rejection Motion would be heard on October 9, 2001. (ER 38-40.) The notice stated that opposition could be filed at any time prior to the hearing. (*Id.*)

On October 4, 2001, Pacific Shores filed a Limited Objection to Debtors' Lease Rejection Motion. (ER 41-50.) Pacific Shores' Limited Objection did not contest At Home's business decision to reject the leases, but did object to At Home's attempt to have the rejection apply retroactively to the date of the Lease Rejection Motion. (ER 41-42.)

At Home filed a Reply to Pacific Shores Limited Objection on October 5, 2001. (ER 51-62.) The Reply stated that "the Debtors have never occupied the premises covered by the Pacific Shores' leases." (*Id.*) The Reply did not deny that At Home retained legal possession of the Pacific Shores Premises.

On October 9, 2001, a hearing was held on At Home's Lease Rejection Motion. At the conclusion of the hearing, the Bankruptcy Court orally granted At Home's motion, ordering rejection of the Pacific Shores' leases retroactive to the date of the Lease Rejection Motion. (App., *infra*, 42a-44a.)

The Bankruptcy Court observed, "This case wouldn't be interesting and wouldn't even be here except for a fairly interesting amount of rent per month.... [T]here's a fair amount of money at stake." (App., *infra*, 43a.) At Home

had advised the Bankruptcy Court that the post-petition rent obligation would be $1 million per month, unless retroactivity was ordered. (ER 85-86.) The Bankruptcy Court stated, "I look upon this as a close question." (App., *infra*, 44a.) The Court explained the basis for its decision to grant retroactive relief as follows:

First, "the Debtor moved immediately upon filing for relief - to reject the lease, rather." (App., *infra*, 43a.) Second, "the Debtor set this matter for hearing promptly. It wasn't perfect. It wasn't done absolutely as soon as possible, but it was done without any delays." (App., *infra*, 43a.) The Court also stated that "You can do it faster than this, and that's what the Debtor ought to do." (App., *infra*, 44a.) The Court was referring to the Debtor's failure to seek a stipulation from Pacific Shores or the United States Trustee regarding the relief sought by the motion. (App., *infra*, 44a.) Third, "the Debtor is not in possession of the premises" (App., *infra*, 43a),[2] although the landlord was delayed in receiving "its indefeasible right to re-let the premises." (App., *infra*, 43a.) Finally, Pacific Shores only opposed "any nunc pro tunc effect generally without any suggestion here that this process should be speeded up." (App., *infra*, 43a.)

The Bankruptcy Court's Order Authorizing Rejection of Unexpired Leases of Nonresidential Real Property ("Lease Rejection Order") was entered on October 23, 2001. (ER 107-109.) The Lease Rejection Order states that the leases

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[2] The District Court (App., *infra*, 38a-39a) and the Court of Appeals (App., *infra*, 20a-21a n. 5) both concluded that the Bankruptcy Court apparently was referring to the fact that At Home was not physically occupying the premises, not that it lacked legal possession.

"are rejected effective *nunc pro tunc* to the date of the Motion." (*Id.*)

The District Court affirmed. (App., *infra*, 25a-41a, reported at 292 B.R. 195 (N.D. Cal. 2003).

The United States Court of Appeals for the Ninth Circuit affirmed the District Court and the Bankruptcy Court (App., *infra*, 3a-24a), holding "that a bankruptcy court may approve retroactively the rejection of an unexpired non-residential lease." (App., *infra*, 3a.) The Court adopted the conclusion of the First Circuit in *Thinking Machines Corp. v. Mellon Fin. Serv. Corp.* (*In re Thinking Machines Corp.*), 67 F.3d 1021 (1st Cir. 1995) that "although rejection of an unexpired non-residential lease does not take effect until court approval, 'the approving court has the equitable power, in suitable cases, to order a rejection to operate retroactively.'" (App., *infra*, 3a-4a.) The Ninth Circuit further held "that the retroactive date may be earlier than the date on which the landlord retakes possession of the premises." (App., *infra*, 4a.) The Ninth Circuit recognized that in Section 365(d)(3), "Congress sought to protect the interests of commercial landlords who, compared to other creditors, were unfairly disadvantaged because they were forced to continue extending credit - in the form of rent - during the pendency of reorganization proceedings." (App., *infra*, 9a.) The Ninth Circuit nevertheless concluded that Section 105(a) of the Bankruptcy Code empowered the Bankruptcy Court to order rejection of a lease retroactive prior to the landlord's recovery of possession because the term "possession" is not used in Section 365(d)(3) but instead Section 365(d)(3) makes the operative event assumption or rejection of the lease. (App., *infra*, 13a-15a.) The Ninth Circuit declined to "hamstring bankruptcy courts" by precluding retroactive rejection where

the landlord is involuntarily deprived of possession. (App., *infra*, 17a.)

The Ninth Circuit further held that the Bankruptcy Court did not abuse its discretion in making its order retroactive. There was only "minimal delay" (App., *infra*, 19a) and the "Debtor brought its motion before the court as the earliest practicable date." (App., *infra*, 20a.) Notwithstanding the automatic stay, the fact that the Debtor was not physically occupying the premises made "it easier for the landlord to re-let" the premises. (App., *infra*, 22a.) The landlord did nothing to speed up the process and was apparently motivated by its desire to obtain administrative rent, and the amount thereof is a relevant factor. (App., *infra*, 22a.)

Pacific Shores' petition for rehearing or rehearing en banc was denied on February 15, 2005. (App., *infra*, 1a-2a.)

## REASONS WHY THE WRIT SHOULD BE GRANTED

This petition for a writ of certiorari should be granted for two principal reasons.

The first reason for granting the writ is that the decision of the Court of Appeals conflicts in principle with Supreme Court precedent holding that a bankruptcy court cannot exercise its equitable powers to take away a valid claim or to act contrary to express provisions of the Bankruptcy Code. Section 365(d)(3) of the Bankruptcy Code obligates the trustee or debtor in possession[3] to perform all obligations "arising

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[3] In a Chapter 11 bankruptcy, a debtor in possession such as At Home has essentially the same rights, power, and duties as a trustee, including the right to assume or reject a lease, subject to

from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected...." This statute thus grants the landlord a corresponding right to rent that comes due during the same period. A retroactive rejection deprives a landlord of this right to rent, in violation of Section 365(d)(3). A retroactive rejection constitutes an exercise of equitable powers to deprive the landlord of such rent; retroactivity serves no other purpose.

Furthermore, the purpose of Section 365(d)(3) is consistent with the plain meaning of that section. Section 365(d)(3) was intended to compensate landlords for the period that they are deprived of possession prior to rejection of a lease.

Although a retroactive rejection may not be inconsistent with this purpose where the landlord has already recovered possession of the leased premises, a retroactive rejection and concomitant elimination of the landlord's right to rent where the landlord has involuntarily been deprived of possession of its property, and is barred by the automatic stay from retaking possession, violates Section 365(d)(3) and is beyond the equitable powers of the bankruptcy court, because those equitable powers do not extend to deprivation of a right to compensation created by Congress.

The second reason for granting the writ is that retroactive rejection is a recurring issue in bankruptcy cases filed by commercial tenants, who often reject leases and seek to make such rejections retroactive.

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court approval. 11 U.S.C. §§ 1107(a), 1108. *Cukierman v. Uecker* (*In re Cukierman*), 265 F.3d 846, 849 (9th Cir. 2001).

## I. The Decision of the Court of Appeals Conflicts in Principle With Supreme Court Precedent that Equitable Powers Cannot Be Exercised to Deprive a Party of a Valid Claim.

A bankruptcy court cannot exercise its equitable powers to take away a valid claim or to act contrary to express provisions of the Bankruptcy Code. *United States v. Noland,* 517 U.S. 535, 539 (1996); *United States v. Reorganized CF&I Fabricators of Utah, Inc.,* 518 U.S. 213 (1996). "Section 105 does not allow the bankruptcy court to override explicit mandates of other sections of the Bankruptcy Code ...." 2 *Collier on Bankruptcy* ¶ 105.01[2] at p. 105-7 (15th rev. ed. 2004). "[W]hatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." *Norwest Bank Worthington v. Ahlers,* 485 U.S. 197, 206 (1988). Although a bankruptcy court "is a court of equity, it is not free to adjust the legally valid claim of an innocent party who asserts the claim in good faith merely because the court perceives that the result is inequitable." *Noland,* 517 U.S. at 539; *see also Reorganized CF&I Fabricators,* 518 U.S. 213.[4] As summarized by the Seventh Circuit, "[I]t is now well settled that although the origins, procedures, and many of the remedies of bankruptcy are indeed equitable, a bankruptcy judge has no authority to cut down the entitlements that creditors seek to enforce in bankruptcy, except as provided by the Bankruptcy Code itself." *In re Stoecker,* 179 F.3d 546, 551 (7th Cir. 1999).

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[4] Although these cases dealt with equitable subordination under 11 U.S.C. § 510(c), they are applicable to an analysis under Section 105. Collier, ¶ 105.04[5][a] at p. 105-75.

Section 365(d)(3) creates a legally valid claim in favor of a landlord for post-petition, pre-rejection rent.[5] Section 365(d)(3) provides, "The trustee shall timely perform all the obligations of the debtor ... arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title." The trustee must perform the tenant's obligations until the lease is rejected. "Until the trustee assumes or rejects an unexpired lease of nonresidential real property, the trustee must perform obligations under that lease in accordance with 11 U.S.C. § 365(d)(3)." *Cukierman v. Uecker (In re Cukierman)*, 265 F.3d 846, 849 (9th Cir. 2001); a*ccord*, *Koenig Sporting Goods, Inc.v. Morse Road Co. (In re Koenig Sporting Goods, Inc.)*, 203 F.3d 986, 989 (6th Cir. 2000); *Centerpoint Propertiesv. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 268 F.3d 205, 206 (3d Cir. 2001); *Ha-Lo Industries, Inc. v. Centerpoint Properties Trust*, 342 F.3d 794 (7th Cir. 2003).

One such obligation is the obligation to pay rent. Indeed, Section 365(d)(3) "was enacted to ameliorate the immediate financial burden borne by lessors of nonresidential property during the period in which trustees decided whether to assume a lease." *Towers v. Chickering & Gregory (In re Pacific Atlantic Trading Co.)*, 27 F.3d 401, 403 (9th Cir. 1994) "The

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[5]"It is a technical misnomer to refer to something as 'prepetition' or 'postpetition,' as the date on which the order for relief is granted is the true dividing line. [Citation omitted.] Usually, but not always, the date on which the petition is filed and the date on which the order for relief is granted are the same." *Ha-Lo Industries, Inc. v. Centerpoint Properties Trust*, 342 F.3d 794, 798 n. 2 (7th Cir. 2003).

purpose is evident from the legislative history." *Cukierman*, 265 F.3d at 851 (citing Senator Hatch's comments when submitting the conference report for the bill containing § 365(d)(3)). Senator Hatch's comments were as follows:

> A second and related problem is that during the time the debtor has vacated space but has not yet decided whether to assume or reject the lease, the trustee has stopped making payment due under the lease. These payments include rent due the landlord and common area charges which are paid by all the tenants according to the amount of space they lease. In this situation the landlord is forced to provide current services - the use of its property, utilities, security and other services -without current payment. No other creditor is put in this position. 130 Cong. Rec. S8887, 8895 (daily ed. June 29, 1984), *reprinted in* 1984 U.S.C.C.A.N. 576, 590, 599.

The Sixth Circuit concluded, "The legislative history also suggests that the purpose was 'to relieve the burden placed on nonresidential real property lessors (or 'landlords') during the period between a tenant's bankruptcy petition and assumption or rejection of a lease.'" *Koenig Sporting Goods, Inc. v. Morse Road Co.* (*In re Koenig Sporting Goods, Inc.*), 203 F.3d 986, 989 (6th Cir. 2000) (citation omitted).

Thus, the plain wording of the statute, coupled with its legislative history, establish that Section 365(d)(3) entitles a landlord to recover "rent" for the pre-rejection period during which the landlord is deprived of "the use of its property" even though "the debtor has vacated."

The reason for providing such compensation is that, prior to rejection of a lease, the landlord is *involuntarily* deprived

of possession of the property subject to the lease. An unexpired lease is property of the estate of the debtor. *48th Street Steakhouse, Inc. v. Rockefeller Group, Inc.* (*In re 48th Street Steakhouse, Inc.*), 835 F.2d 427, 430 (2d Cir. 1987), *cert. denied*, 485 U.S. 1035 (1988); 11 U.S.C. § 541. After the filing of a bankruptcy petition by a tenant, a landlord is barred by the automatic stay from taking possession of the leased premises until entry of a lease rejection order. *Robinson v. Chicago Housing Authority*, 54 F.3d 316, 317-318 (7th Cir. 1995); 11 U.S.C. § 362. Thus, a landlord is involuntarily required to allow a tenant that files for bankruptcy to remain in possession of the landlord's premises.

A retroactive rejection violates the plain meaning of Section 365(d)(3), because a retroactive rejection deprives the landlord of rent that it would otherwise be entitled to receive under Section 365(d)(3). A retroactive rejection is also contrary to the legislative intent that the landlord receive rent that comes due prior to rejection of the lease, during which period the landlord is prevented, by the automatic stay, from taking possession of, and using, its property that is subject to the lease.[6]

A retroactive order cannot turn back the calendar and put the landlord in possession of its real estate as of an earlier date, and cannot enable the landlord to lease the premises to a new tenant as of an earlier date. The only purpose and

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[6] A retroactive rejection may also relieve the tenant (and its insurer) from liability for damage to the premises that occurs during the post-petition, pre-rejection period and that may not be known to the landlord at the time of the hearing. A retroactive rejection may leave the landlord without a remedy for such damage.

effect of a retroactive order is to deprive the landlord of the rent that Section 365(d)(3) obligates the debtor to pay.

The Court of Appeals did not explain how it reconciled its decision with this Court's decisions in *Noland* and *Reorganized CF&I Fabricators*, and indeed the Court of Appeals did not cite or discuss these precedents. Although the Court of Appeals recognized the purpose of Section 365(d)(3) (App., *infra*, 7a-10a), and recognized that a bankruptcy court does not have a "'roving commission to do equity'" (*id.* at 13a [citation omitted]), it never explained how, consistent with *Noland* and *Reorganized CF&I Fabricators*, a bankruptcy could properly exercise its equitable powers to deprive a landlord of its right to rent "until such lease is ... rejected."

The Court of Appeals focused on the debtor's "decision to reject the lease, rather than the landlord's eventual possession of the leased premises." (App., *infra*, 16a.) The debtor's decision to reject a lease, however, is of no legal significance because, until the lease rejection order is entered, the lease remains property of the bankruptcy estate and the automatic stay prevents the landlord from retaking possession and leasing the space to another tenant. *Robinson*, 54 F.3d at 317-318. The decision to reject the lease does not terminate the automatic stay or enable the landlord to use and possess the leased premises. Accordingly, the plain meaning and purpose of Section 365(d)(3) do not excuse the debtor from paying rent or performing obligations under its lease when the debtor decides to reject the lease; those obligations continue until the lease rejection order is entered. Moreover, "Interpreting 365(d)(3) as a bright-line rule, encompassing all obligations contained in a bargained-for agreement, ensures prompt performance of lease obligations by bankruptcy trustees." *Cukierman*, 265 F.3d at 850-51.

The only situations in which retroactivity may be appropriate are those where the landlord has not *involuntarily* been deprived of possession of its property. For example, where (unlike this case) the landlord has recovered possession prior to the hearing of the lease rejection motion, the landlord has not been involuntarily deprived of possession and use of its property prior to rejection of the lease, and in such a case a rejection retroactive to the date the landlord recovered possession would not be inconsistent with the purpose of Section 365(d)(3). The lower federal courts have generally ordered retroactivity where the landlord had already been restored to possession, and have generally denied retroactivity where the tenant has remained in possession. *TW, Inc. v. Angelastro (In re TW, Inc.)*, 2004 WL 115521 (D. Del. 2004) (retroactive rejection denied because debtor did not return keys); *Stonebriar Mall Limited Partnership v. CCI Wireless, LLC (In re CCI Wireless, LLC)*, 297 B.R. 133 (D. Colo. 2003), aff'g 279 B.R. 590 (landlords had changed the locks or otherwise taken possession of at least four of the five locations at issue prior to the date to which the order was retroactive [279 B.R. at 593]); *In re New Valley Corp.*, 2000 WL 1251858 *15 (D.N.J. 2000) (rejection retroactive only to date landlord had "resumed full control" of the property); *In re Chi-Chi's*, 305 B.R. 396 (Bankr. D. Del. 2004) (rejection retroactive to date possession surrendered to landlord); *In re O'Neil Theatres, Inc.*, 257 B.R. 806, 808 (Bankr. E.D. La. 2000) (the debtor ceased operations and vacated the premises two weeks prior to the filing of the petition for relief; landlord "padlocked the leased premises the next day, thereby exercising full dominion and control over the property"); *In re Amber's Stores, Inc.*, 193 B.R. 819, 826 (Bankr. N.D. Tex. 1996) (retroactivity granted to the motion date because the debtor had turned over the keys and hence the landlord had possession).

Retroactivity where the landlord has already recovered possession is not inconsistent with the purpose of Section 365(d)(3) because the landlord has recovered the right and ability to lease to, and obtain rent from, a replacement tenant.

A second situation where retroactivity might be appropriate is where the landlord delayed its own recovery of possession by delaying the hearing of the lease rejection motion with a frivolous objection. *See In re Jamesway Corp.*, 179 B.R. 33, 36 (S.D.N.Y. 1995). Where the landlord has delayed its own recovery of possession, the denial of possession is not involuntary, and the landlord can hardly be heard to complain about the delay.

Prior to the decision of the Ninth Circuit in this case, the only Court of Appeals case to consider retroactive lease rejection was *Thinking Machines Corp. v. Mellon Fin. Serv. Corp.* (*In re Thinking Machines Corp.*), 67 F.3d 1021 (1st Cir. 1995). In that case, the First Circuit's discussion of retroactivity is dictum; the Court did not decide whether retroactivity could be ordered to a date prior to the landlord's recovery of possession; and the rationale as applied to a lease rejection order that is retroactive to a date prior to the landlord's possession is inconsistent with this Court's subsequent decisions in *Noland* and *Reorganized CF&I Fabricators*.

Where, as here, the landlord has involuntarily been deprived of possession of its premises until the lease rejection is ordered, the debtor has a statutory obligation to pay rent until the lease is rejected, as specified in Section 365(d)(3), and the landlord has a corresponding right to receive such rent. *Noland* and *Reorganized CF&I Fabricators* establish that a statutory right to compensation cannot be taken away by the exercise of equitable power by a bankruptcy court. A

retroactive rejection violates this principle, because such an order deprives the landlord of its statutory right to pre-rejection rent.

Thus, because the Ninth Circuit's decision conflicts in principle with *Noland* and *Reorganized CF&I Fabricators*, the writ should be granted.

**II. The Issue is a Recurring One.**

The writ should also be granted because the issue of retroactive rejection is a recurring one of interest to judges and practitioners. The Bankruptcy Court observed that the issue "came up at our Judges' Panel, can you reject on the petition date, and I think we all said no, you can try and you can probably get it really soon thereafter...." (App., *infra*, 44a.) Nevertheless, the Bankruptcy Court made the rejection in this case retroactive to the date of the Lease Rejection Motion, which was filed on the petition date. Thus, the issue is of interest to Bankruptcy Court judges.

In addition, as the reported cases discussed above demonstrate, the issue arises frequently. Of course, it arises even more often in the unpublished proceedings of the bankruptcy courts. It is an issue in the many multi-location retail and office bankruptcy cases in which rejection of leases is one of the reasons for filing for bankruptcy protection. In such cases, it is common for the debtors to seek to have their lease rejections made retroactive.

In light of the frequency with which the issue arises, and in light of the conflict in principle between the only two court of appeals' decisions to address the issue, on the one hand, and this Court's decisions in *Noland* and *Reorganized CF&I Fabricators*, on the other hand, the issue is an important one

concerning interpretation of the Bankruptcy Code that should be settled.

## CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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## APPENDIX A

## UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

**No. 03-15769**

**[Filed, February 15, 2005]**

| | |
|---|---|
| In re: AT HOME CORPORATION, a Delaware corporation, Debtor. | ) |
| PACIFIC SHORES DEVELOPMENT, LLC Appellant, | ) |
| v. | ) |
| AT HOME CORPORATION, dba Excite at Home, Appellee. | ) |

### ORDER

HALL, BRUNETTI, and GRABER, Circuit Judges.

The panel has voted to deny the petition for panel rehearing. Judge Graber has voted to deny the petition for

rehearing en banc, and Judges Hall and Brunetti have so recommended.

The full court has been advised of the petition for rehearing en banc and no judge of the court has requested a vote on it.

The petition for panel rehearing and petition for rehearing en banc are DENIED.

## APPENDIX B

## UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

**No. 03-15769**

**[Filed, December 28, 2004]**

| | |
|---|---|
| In re: AT HOME CORPORATION, a Delaware corporation, Debtor. | ) |
| PACIFIC SHORES DEVELOPMENT, LLC, Appellant, | ) |
| v. | ) |
| AT HOME CORPORATION, dba Excite at Home, Appellee. | ) |

## OPINION

GRABER, Circuit Judge.

In this appeal, we hold that a bankruptcy court may approve retroactively the rejection of an unexpired nonresidential lease. We adopt the First Circuit's conclusion in *Thinking Machs. Corp. v. Mellon Fin. Servs. Corp. (In re*

*Thinking Machs. Corp.)*, 67 F.3d 1021, 1029 (1st Cir. 1995): although rejection of an unexpired nonresidential lease does not take effect until court approval, "the approving court has the equitable power, in suitable cases, to order a rejection to operate retroactively." We further hold that the retroactive date may be earlier than the date on which the landlord retakes possession of the premises. Here, the bankruptcy court permissibly allowed the debtor to reject the leases as of the date on which the debtor filed its motion seeking to reject them. Accordingly, we affirm.

BACKGROUND

In happier times, Debtor At Home Corporation was actively engaged in the delivery of "broadband" network services to residential customers. As part of an aggressive growth strategy, in early 2000 Debtor leased two buildings from Pacific Shores Development Corporation, LLC. Debtor placed in escrow approximately $20 million to fund the remodeling of the two leased buildings. Debtor intended to occupy the premises upon completion of the renovation.

But things did not go as planned. Debtor filed for Chapter 11 bankruptcy protection on September 28, 2001. Although the renovation was "virtually complete" by then, Debtor had never occupied the leased buildings. Debtor did not furnish Pacific Shores with a formal surrender notice before seeking protection under Chapter 11; it feared that Pacific Shores would convert more than $ 1 million, which remained in the escrow account for remodeling, into rent. Indeed, that conversion apparently took place on the same day that Debtor filed its bankruptcy petition.

Also on that same day, Debtor filed an "Emergency Motion for Order Pursuant to 11 U.S.C. § 365(a) Authorizing

Rejection of Unexpired Leases of Nonresidential Real Property." That motion sought an order rejecting the leases *nunc pro tunc* to September 28, the date on which the motion was filed. Pacific Shores did not quarrel with the decision to reject the leases, but objected to the motion "to the extent it seeks retroactive rejection of [the] leases." The parties contested this point because the effective date of rejection of the leases governed whether Debtor would owe Pacific Shores more than $1 million in additional rent.

During the "first day emergency motions" hearing on October 1, 2001, Debtor asked the court to schedule a hearing on its motion to reject the leases "early next week." On October 1 a committee of creditors had not yet formed. Because the following Monday was a court holiday, the bankruptcy court scheduled the hearing for Tuesday, October 9, 2001.

At the October 9 hearing, the bankruptcy court heard argument from Pacific Shores, Debtor, the United States trustee, and the newly formed creditors' committee. The bankruptcy court then rendered an oral decision in which it concluded that a *nunc pro tunc* order was appropriate because: (1) Debtor moved to reject the lease immediately upon filing its bankruptcy petition; (2) Debtor set the matter for hearing promptly; (3) Debtor was "not in possession of the premises"; and (4) Pacific Shores opposed *nunc pro tunc* rejection without having suggested "that this process should be speeded up so that [Pacific Shores] could get . . . its indefeasible right to re-let the premises." In other words, Pacific Shores's sole "interest [was] in running the administrative rent." The court later issued a written order approving the retroactive rejection of the leases.

Pacific Shores challenged the bankruptcy court's order in district court. The district court affirmed the bankruptcy court in a published opinion. *Pac. Shores Dev., LLC v. At Home Corp. (In re At Home Corp.)*, 292 B.R. 195 (N.D. Cal. 2003). Relying on *Thinking Machines*, the district court held that 11 U.S.C. § 365(d) permits a bankruptcy court to order the rejection of a nonresidential lease retroactive to an earlier date, whether or not the landlord was in possession of the leased premises on that date. *Id.* at 202. The court also held that, on the facts of this case, the bankruptcy court did not abuse its discretion by approving Debtor's rejection of its leases retroactive to the September 28 filing date. *Id.* at 204.

Pacific Shores timely appealed to this court.

## STANDARDS OF REVIEW

We conduct an independent review of a bankruptcy court's decision. *Brewer v. Erwin & Erwin, P.C. (In re Marquam Inv. Corp.)*, 942 F.2d 1462, 1465 (9th Cir. 1991). We review for abuse of discretion a bankruptcy court's entry of a *nunc pro tunc* approval of a motion. *Atkins v. Wain, Samuel & Co. (In re Atkins)*, 69 F.3d 970, 973 (9th Cir. 1995). A court abuses its discretion if it does not apply the correct law or if it rests its decision on a clearly erroneous finding of material fact. *Bird v. Lewis & Clark Coll.*, 303 F.3d 1015, 1020 (9th Cir. 2002).

## DISCUSSION

Pacific Shores agrees that, as a general matter, a bankruptcy court may exercise its equitable powers to approve the rejection of a nonresidential lease retroactively. Nonetheless, Pacific Shores contends that the bankruptcy court erred in two respects. First, Pacific Shores argues that

the bankruptcy court lacked authority to approve the rejection of the leases to a date *before* the date on which Pacific Shores, as landlord, regained possession of the premises. Second, Pacific Shores takes issue with the factors on which the bankruptcy court relied in granting Debtor's motion.

Our task is to identify the authority for, and the limits of, a bankruptcy court's discretion in this context. We will begin by analyzing 11 U.S.C. § 365(d), which controls the treatment of unexpired nonresidential leases in Chapter 11 proceedings, and the cases discussing the effective date of lease rejection under the statute. We then will turn to an analysis of the bankruptcy court's decision.

A. *Equitable authority under 11 U.S.C. § 365(d).*

1. *The Shopping Center Amendments changed the treatment of unexpired nonresidential leases in Chapter 11 bankruptcy proceedings.*

The parties' dispute turns on the text and purpose of 11 U.S.C. § 365(d), which sets forth a debtor's duties under a nonresidential lease once the debtor has filed for bankruptcy protection. The relevant subsections of § 365(d) provide:

> (3) The trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title. The court may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date of the order for relief, but the time for performance shall not be extended beyond such 60-day

> period. . . . Acceptance of any such performance does not constitute waiver or relinquishment of the lessor's rights under such lease or under this title.
>
> (4) . . . In a case under any chapter of this title, if the trustee[1] does not assume or reject an unexpired lease of nonresidential real property under which the debtor is the lessee within 60 days after the date of the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such lease is deemed rejected, and the trustee shall immediately surrender such nonresidential real property to the lessor.

11 U.S.C.§ 365(d)(3)-(4).

Those subsections impose two obligations on a trustee or debtor with respect to unexpired nonresidential leases. First, § 365(d)(3) makes clear that the debtor must perform all obligations owing under a lease--particularly the obligation to pay rent at the contract rate--until the lease is rejected. Second, § 365(d)(4) requires a debtor or trustee to decide whether to assume or reject a lease within 60 days after the filing of a bankruptcy petition. If the trustee fails to act within 60 days, the lease is "deemed rejected" and the trustee must "immediately surrender such nonresidential real property to the lessor." 11 U.S.C. § 365(d)(4).

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[1] Although § 365(d) refers to the "trustee," courts have held that either the trustee or the debtor may move for an order rejecting an unexpired noncommercial lease. *See, e.g., In re Amber's Stores, Inc.*, 193 B.R. 819, 826 (Bankr. N.D. Tex. 1996). In a Chapter 11 bankruptcy, a debtor-in-possession performs essentially all the functions of a trustee. 11 U.S.C. § 1107(a); *Cukierman v. Uecker (In re Cukierman)*, 265 F.3d 846, 849 (9th Cir. 2001).

Those duties arose out of the so-called "Shopping Center Amendments" contained in the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984). Through those amendments, Congress sought to protect the interests of commercial landlords who, compared to other creditors, were unfairly disadvantaged because they were forced to continue extending credit--in the form of rent--during the pendency of reorganization proceedings. *See* 130 Cong. Rec. S8891 (1984), *reprinted in* 1984 U.S.C.C.A.N. 590, 598-99 (statement of Sen. Hatch) (discussing problem).

Specifically, Congress enacted the Shopping Center Amendments to tackle two main problems. "The first problem which [the Amendments] would remedy is the long-term vacancy or partial operation of space by a bankrupt tenant." *Id.* at 598. Previously, a debtor could file a Chapter 11 bankruptcy petition and then maintain control of the leased property for the entire duration of the bankruptcy proceedings, even if the debtor had ceased operations and had vacated the premises. The automatic stay prevented the landlord from evicting the debtor or regaining possession of the leased space. The landlord lost money, and the extended vacancy hurt other tenants in the same shopping center as the bankrupt tenant because of decreased customer traffic. *Id.* at 599.

"A second and related problem is that during the time the debtor has vacated space but has not yet decided whether to assume or reject the lease, the trustee has stopped making payments due under the lease." *Id.* Again, this problem affected both the landlord and the other shopping-center tenants. "The landlord [was] forced to provide current services--the use of its property, utilities, security, and other services--without current payment." *Id.* Other tenants could be required to increase their "common area charge payments"

to make up for the fact that the bankrupt tenant was no longer contributing to common area charges. *Id.* The landlord eventually received only the court-determined "actual, necessary costs and expenses of preserving the estate," 11 U.S.C. § 503(b)(1)(A), rather than the rent that would have been due under the terms of the lease. Thus, landlords could not rent the unused space until the proceedings terminated, and they received only "an amount equal to the reasonable value of the debtor's actual use and occupation of the property" during those proceedings. *Towers v. Chickering & Gregory (In re Pacific-Atlantic Trading Co.)*, 27 F.3d 401, 403 (9th Cir. 1994).

The Shopping Center Amendments solved those two problems by ensuring that a commercial tenant who seeks protection under Chapter 11 continues to perform its obligations under the lease--including the obligation to pay the full amount of rent "notwithstanding section 503(b)(1)"--until the lease is rejected. By requiring the tenant to pay administrative rent until it rejects the lease, and by providing for automatic rejection of the lease after 60 days, the Amendments ensure that the tenant determines promptly whether to assume or reject the lease, rather than taking advantage of the automatic stay.

2. Thinking Machines *appropriately recognized bankruptcy courts' equitable authority under 11 U.S.C. § 365(d).*

Soon after Congress enacted the Shopping Center Amendments, courts began to arrive at contrary conclusions with respect to when a lease rejection takes effect. Much depends on that conclusion, because the effective date of rejection determines when a debtor's obligation to pay rent ceases. Under the "majority view," the rejection of a lease becomes effective upon entry of a court order approving a

trustee's or debtor's motion to reject an unexpired nonresidential lease. *See, e.g., Paul Harris Stores, Inc. v. Mabel L. Salter Realty Trust (In re Paul Harris Stores, Inc.)*, 148 B.R. 307, 309 (S.D. Ind. 1992); *In re Federated Dep't Stores, Inc.*, 131 B.R. 808, 815-16 (S.D. Ohio 1991). This view regards court approval as a "condition precedent" to the rejection of a lease. *Thinking Machs.*, 67 F.3d at 1025.[2] Under the "minority view," lease rejection is effective upon filing the motion to reject. Thus, "court approval [is] not . . . a condition precedent to an effective assumption or rejection, but rather [is] a safeguard subjecting the decision of the trustee (and its business judgment) to review and possible reversal." *In re Joseph C. Spiess Co.*, 145 B.R. 597, 601 (Bankr. N.D. Ill. 1992).

The First Circuit undertook to mend "the seeming rift in the case law" between the majority and minority views. *Thinking Machs.*, 67 F.3d at 1028. After thoroughly reviewing the cases on both sides, the court adopted the majority view, concluding that "section 365(a) is most faithfully read as making court approval a condition precedent to the effectiveness of a trustee's rejection of a nonresidential lease." *Id.* at 1025. At the same time, the court emphasized that "nothing in our holding today precludes a bankruptcy court, in an appropriate section 365(a) case, from approving a trustee's rejection of a nonresidential lease retroactive to the motion filing date." *Id.* at 1028. That proviso reconciled the competing approaches and yielded a "single black-letter" rule:

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[2] Court approval is unnecessary only when a lease is "deemed rejected," pursuant to § 365(d)(4), because of a failure to assume or reject the lease within 60 days of filing for bankruptcy protection. *Ariz. Appetito's Stores, Inc. v. Paradise Village Inv. Co. (In re Ariz. Appetito's Stores, Inc.)*, 893 F.2d 216, 219 (9th Cir. 1990).

"rejection under section 365(a) does not take effect until judicial approval is secured, but the approving court has the equitable power, in suitable cases, to order a rejection to operate retroactively." *Id.* at 1029.

Many bankruptcy courts have since implemented *Thinking Machines*' black-letter rule. *See, e.g.*, *Stonebriar Mall Ltd. P'ship v. CCI Wireless, LLC (In re CCI Wireless, LLC)*, 297 B.R. 133, 138 (D. Colo. 2003); *In re Amber's Stores, Inc.*, 193 B.R. 819, 827 (Bankr. N.D. Tex. 1996). Even those courts that deny retroactive relief do so as a matter of discretion, rather than as a matter of law. *See, e.g.*, *In re Chi-Chi's, Inc.*, 305 B.R. 396, 399 (Bankr. D. Del. 2004) ("The Court finds that it will not exercise its equitable power to deem the Landlords' leases rejected as of the Petition Date."). Indeed, the equitable authority recognized in *Thinking Machines* has been imported to contexts other than unexpired nonresidential leases. *See, e.g.*, *Malden Mills Indus., Inc. v. Maroun (In re Malden Mills Indus., Inc.)*, 303 B.R. 688, 701 (B.A.P. 1st Cir. 2004) (applying approach to abandonment of personal property).

Even before *Thinking Machines*, some courts had allowed retroactive rejection of a nonresidential lease, reasoning that nothing in § ]365(d) expressly prevents a bankruptcy court from exercising its equitable powers to approve a retroactive rejection. As the Southern District of New York explained in *Constant Ltd. Partnership v. Jamesway Corp. (In re Jamesway Corp.)*, 179 B.R. 33, 37 (S.D.N.Y. 1995), § 365(d) "does not state that rejection cannot be applied retroactively, or that there are restrictions as to the manner in which the court can approve rejection." The district court below similarly observed that § 365(d) does not specify whether a bankruptcy court may order the rejection of a lease

retroactive to the motion filing date. *At Home Corp.*, 292 B.R. at 199.

But statutory silence alone does not invest a bankruptcy court with equitable powers. Those powers are limited and do not amount to a "'roving commission to do equity.'" *Saxman v. Educ. Credit Mgmt. Corp. (In re Saxman)*, 325 F.3d 1168, 1175 (9th Cir. 2003) (quoting *United States v. Sutton*, 786 F.2d 1305, 1308 (5th Cir. 1986)). The Bankruptcy Code limits the equitable powers of bankruptcy courts to the issuance of "any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." 11 U.S.C. § 105(a). Thus, a bankruptcy court must locate its equitable authority in the Bankruptcy Code. *See Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206, 99 L. Ed. 2d 169, 108 S. Ct. 963 (1988) ("Whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.").

Fortunately, we need look no further than § 365(d) itself to see that, in appropriate cases, retroactive lease rejection may be "necessary or appropriate to carry out" this provision of Title 11. 11 U.S.C. § 105(a). As we have noted, one of the chief purposes of the Shopping Center Amendments was to remedy the "long-term vacancy" of leased premises during protracted bankruptcy proceedings. *See* 1984 U.S.C.C.A.N. at 598-99 (lamenting that under the then-existing version of § 365 "tenant space has been vacated for extended periods of time before the bankruptcy court forced the trustee to decide whether to assume or reject the lease"). Together, §§ 365(d)(3) and (d)(4) operate to force the debtor-tenant to decide quickly whether to assume or reject an unexpired non-residential lease.

Similarly, *Thinking Machines* observed that retroactive lease rejection had the "salutary side effect" of acting "as a stimulus to all parties to cooperate in getting the trustee's motion to reject heard and determined at the earliest practicable date." 67 F.3d at 1028. So courts generally focus on whether the parties have facilitated or hindered the prompt return of the leased premises to the landlord when deciding whether to approve the rejection of a lease retroactive to an earlier date. For example, the court in *In re Amber's Stores* approved the rejection of a lease *nunc pro tunc* to the motion filing date because the debtor "had turned over the keys and vacated the premises pre-petition, and served a motion to reject the lease as soon as possible." 193 B.R. at 827. By so doing, the debtor had acted to further the intended purposes of § 365(d): the prompt rejection of the lease and the return of the leased premises to the landlord's possession. Thus, equitable relief was appropriate. *Id.*

*In re Amber's Stores* is a faithful application of both *Thinking Machines*' black-letter rule and the provisions of § 365(d) themselves. Indeed, neither party argues, nor does any relevant authority suggest, that the exercise of a bankruptcy court's equitable powers in similar circumstances runs counter to § 365(d) or any other provision of the Bankruptcy Code. We therefore hold that a bankruptcy court, in exercising its equitable powers under 11 U.S.C. § 105(a), may approve the retroactive rejection of a nonresidential lease when "necessary or appropriate to carry out the provisions of" § 365(d).

3. *The landlord's possession of the leased premises is not a requirement for retroactive relief.*

Pacific Shores argues that the bankruptcy court exceeded its equitable powers by approving the rejection of the leases

retroactive to the motion filing date because Debtor, not Pacific Shores, remained in possession of the leased premises on that date. By permitting a rejection predating the landlord's resumption of possession, Pacific Shores contends, the bankruptcy court thwarted the spirit, if not the letter, of § 365(d). We are not persuaded.

The relevant provisions of § 365(d) do not even mention the term "possession," much less elevate it to a condition precedent to a bankruptcy court's exercise of its equitable powers. The legally operative event in § 365(d) is the debtor's or trustee's assumption or rejection of the lease, rather than the landlord's possession of the leased premises.

Congruently, the legislative history refers to a landlord's possession of leased premises only in connection with proceedings by landlords to regain possession of leased premises when the lease has expired by its own terms. 1984 U.S.C.C.A.N. at 600. Like the statute itself, the legislative history focuses on the period of time during which "the debtor has vacated space *but has not yet decided whether to assume or reject the lease.*" *Id.* at 599 (emphasis added). Indeed, the legislative history consistently stresses Congress's intention to hasten the trustee's decision to assume or reject a lease:

> Tenant space has been vacated for extended periods of time *before the bankruptcy court forced the trustee to decide whether to assume or reject the lease*. . . .
>
> The bill would lessen the problems caused by extended vacancies and partial operation of tenant space by *requiring that the trustee decide whether to assume or reject [a] nonresidential real property lease* within 60 days . . . .

*Id.* (emphasis added).

Our earlier cases similarly emphasize the trustee's decision to reject the lease, rather than the landlord's eventual possession of the leased premises. In *In re Pacific-Atlantic Trading*, we interpreted "section 365(d)(3) [to express] the intent of Congress to secure for lessors the full amount of rent due . . . *while the trustee determines to accept or reject the lease.*" 27 F.3d at 405 (emphasis added); *see also Cukierman v. Uecker (In re Cukierman)*, 265 F.3d 846, 849 (9th Cir. 2001) (noting that § 365(d)(3) requires the trustee to perform all lease obligations "until the trustee assumes or rejects an unexpired lease of nonresidential real property").

In the normal course, a landlord will regain possession of leased premises shortly after the trustee decides to reject the lease, and the estate must pay administrative rent covering the time between those two acts. *See Federated Dep't Stores*, 131 B.R. at 815 (stating that, "as a general rule, the party seeking relief in any court must bear the risk that the court may not reach a decision as quickly as the party expected or desired"). But nothing in the text or history of the statute, nor in our case law, suggests that bankruptcy courts are powerless to deviate from the usual rule in appropriate circumstances.

Adopting the interpretation of § 365(d) that Pacific Shores urges would deprive a bankruptcy court of flexibility in molding its orders to reflect the circumstances and the actions of both parties to the lease. In *Jamesway*, for example, the court authorized the rejection of a lease retroactive to the date on which the court would have heard the debtor's motion but for the landlord's frivolous objection and delaying tactics. 179 B.R. at 38. That kind of appropriate relief would be impossible were we to adhere to a strict rule under which the

landlord's regaining possession of the leased premises is a precondition to lease rejection.

Pacific Shores attempts to accommodate *Jamesway* by arguing that, although § 365(d)(3) does not preclude retroactive rejection of a lease when, as in *Jamesway*, a landlord is voluntarily deprived of possession by its own malfeasance, it does preclude retroactive rejection when a landlord is *involuntarily* deprived of possession. Other than *Jamesway* itself, Pacific Shores cites no authority that supports that argument. The statute does not support this proposed distinction.

In the absence of explicit direction from the statute itself, we decline to hamstring bankruptcy courts in this way. We prefer the straightforward approach adopted by the bankruptcy courts in cases such as *Jamesway* and *CCI Wireless*. After concluding that nothing in "section 365 prohibits a bankruptcy court from selecting a retroactive date for the rejection of an unexpired nonresidential lease[,] . . . the court[s] applied an abuse of discretion standard in considering whether the circumstances of the debtor's case merited retroactive rejection." *CCI Wireless*, 297 B.R. at 138 (explaining and adopting the analysis of *Jamesway*). We expressly adopt that approach here.[3]

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[3] In adopting that approach, we necessarily reject Pacific Shores's alternative argument that § 365(d) conditions the retroactive rejection of a lease on the debtor's furnishing its landlord with a formal notice of surrender of the leased premises. As the district court noted, "the cases cited by Pacific Shores discuss surrender as a factor which may weigh in the bankruptcy court's equitable decision to order retroactive relief, but none of them discusses the issue as a distinct legal question or precludes the relief at issue here." *At Home Corp.*, 292 B.R. at 200-01.

Having held that § 365(d) confers on bankruptcy courts the equitable authority to approve the rejection of a lease retroactive to the motion filing date, we next turn to whether the bankruptcy court properly exercised that authority in this case.

B. *The bankruptcy court's decision to grant Debtor's motion.*

"In most cases a lease will be considered rejected as of the date of entry of the order approving the rejection, and only in exceptional circumstances . . . will the court adopt a retroactive date." *In re O'Neil Theatres, Inc.*, 257 B.R. 806, 808 (Bankr. E.D. La. 2000). The bankruptcy court below identified four factors supporting its conclusion that "exceptional circumstances" justified retroactive rejection: (1) the immediate filing of Debtor's motion to reject the leases; (2) Debtor's prompt action in setting that motion for hearing; (3) the fact that Debtor never occupied the premises; and (4) Pacific Shores's motivation in opposing rejection of the leases *nunc pro tunc* to the motion filing date. Pacific Shores challenges all but the first of those factors.

1. *The absence of delay.*

The bankruptcy court began by commenting that Debtor had moved for rejection of the leases immediately upon filing its bankruptcy petition and had scheduled a hearing "virtually as soon as possible":

> It wasn't perfect. It wasn't done absolutely as soon as possible, but it was done without any delay. There was a holiday in here . . . . There was neither any deliberate use of a long notice period to keep their options open nor in fact as I can see it any indifference

> to the timing concerns of the landlord. This is virtually as soon as possible in this particular case.

Pacific Shores takes issue with the bankruptcy court's conclusion that Debtor set its motion for hearing "virtually as soon as possible."

The bankruptcy court itself noted that Debtor should have asked Pacific Shores to stipulate to an immediate rejection of the leases upon filing for bankruptcy. It is, of course, speculative whether Pacific Shores would have agreed, knowing that, by doing so, it would lose $ 1 million in administrative rent. But even if that option had been available, we cannot say that the bankruptcy court's finding that Debtor moved swiftly to reject the leases is clearly erroneous. The minimal delay in bringing the motion to a hearing was due in part to factors outside Debtor's control, including a court holiday and the fact that a creditors' committee had yet to form by the time of the "first day emergency motions."

Pacific Shores nonetheless argues that, in granting Debtor's motion, the bankruptcy court improperly shifted the burden of justifying delay to the landlord. As we noted in *Pacific-Atlantic Trading*, "by requiring the trustee to timely pay the debtor's rent, Congress clearly placed the burden on the trustee to promptly and properly reject the lease if it has no intention of assuming it." 27 F.3d at 405. Several other courts also have interpreted the amended § 365(d)(3) as a mechanism to shift to the debtor the costs of delay. *See, e.g.*, *Paul Harris Stores*, 148 B.R. at 310; *Federated Dep't Stores*, 131 B.R. at 815.

This argument misunderstands the import of the bankruptcy court's finding. The bankruptcy court did not require Pacific Shores to bear the costs associated with a

delay. Rather, the court concluded that there was no appreciable delay in the first place. That conclusion is consistent with the approach taken by other bankruptcy courts in similar situations. In *Paul Harris Stores*, for example, the court held that the effective date of rejection was the date on which the court approved the motion to reject, in part because "the gap in this case-- four months, due in part to extensions of time--could hardly be considered small." 148 B.R. at 311.[4] By contrast, the court in *In re Amber's Stores* granted the motion to reject as of the motion filing date, where the debtor "served a motion to reject the lease *as soon as possible*." 193 B.R. at 827 (emphasis added).

The bankruptcy court found that Debtor brought its motion before the court at the earliest practicable date. *See Thinking Machs.*, 67 F.3d at 1028 (explaining that retroactive relief in § 365 cases encourages resolution of a motion to reject "at the earliest practicable date"). That finding is not clearly erroneous, nor was the court's reliance on it an abuse of discretion.

2. *The vacancy of the leased premises.*

The bankruptcy court next looked to the fact that Debtor never occupied the leased premises.[5] The circumstances of

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[4] Paul Harris Stores addressed the issue of when lease rejection is effective under the statute, rather than the factors to consider in a court's exercise of its equitable powers. Yet the case is instructive insofar as it shows that there is a meaningful distinction between a delay of a few days and a delay of a few months.

[5] In its order, the bankruptcy court said that "the Debtor is not in *possession* of the premises." (Emphasis added.) As Pacific Shores argued below, and as the district court correctly concluded, the

this case are truly unusual; Debtor paid rent on the two leased buildings for more than a year without ever occupying either one. Although we have found no identical cases, those that discuss a tenant's decision whether to vacate the leased premises provide an instructive parallel. In *In re Chi-Chi's, Inc.*, the court denied retroactive relief in part because the tenants remained on the premises even after the entry of the court's order. 305 B.R. at 399. Similarly, in *In re Cafeteria Operators, L.P.*, 299 B.R. 384, 394 (Bankr. N.D. Tex. 2003), the court looked to each one of the debtor's subleases individually and found "that the equities of the case allow rejection retroactive to the later of 1) the date Debtors' Motions were filed or 2) the date the leased space was vacated." Indeed, most cases approving the rejection of a lease retroactively to the motion date highlight the fact that the debtor has vacated the premises. *See, e.g.*, *CCI Wireless*, 297 B.R. at 137 (noting that the debtor "vacated the lease premises before or shortly after the date of filing the Chapter 11 case").

Pacific Shores stresses the legal consequence of the automatic stay. Whether or not the bankrupt tenant has vacated the premises, the landlord cannot re-let the premises while the automatic stay is in effect. So, argues Pacific Shores, occupancy is irrelevant.

But the bankruptcy court focused on the practical effect, rather than the legal significance, of the lack of occupancy.

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bankruptcy court most likely intended a different meaning: "the bankruptcy court was referring to the fact that At Home did not occupy the premises since construction was still ongoing for the buildings in question." *At Home Corp.*, 292 B.R. at 203. We agree with the district court's interpretation of the bankruptcy court's oral ruling

By not occupying the premises, Debtor made "it easier for the landlord to re-let [the buildings]." Nothing in the statute, in the precedents, or in logic precludes the bankruptcy court from considering the practical effects of a tenant's lack of occupancy when balancing the equities in the context of § 365(d)(3). Again, we find no abuse of discretion.

3. *The landlord's conduct and motives.*

Finally, the bankruptcy court "noted that the landlord's opposition was to any [*nunc pro tunc*] effect generally without any suggestion here that this process should be speeded up so that . . . the landlord could get its indefeasible right to re-let the premises more quickly." The court granted the relief requested in part because it was "convinced that the opposition to this relief is motivated by the landlord's interest in running the administrative rent . . . [rather than by] a concern to get this indisputable right to start re-letting the premises as quickly as possible."

A landlord's conduct and motives are relevant to a bankruptcy court's equitable deliberations. For instance, *Jamesway* rested its decision to approve the retroactive rejection of a lease exclusively on the landlord's delay of the hearing on the debtor's motion. 179 B.R. at 38. Although Pacific Shores's conduct here is in no way comparable to the landlord's in *Jamesway*, it does not follow that Pacific Shores's conduct, or its motivation, is altogether irrelevant.

Neither is the amount of rent necessarily irrelevant. Pacific Shores argues that the bankruptcy court, in stating that Pacific Shores was more concerned with obtaining administrative rent than with re-letting the premises, impermissibly weighed the amount of rent in arriving at its decision. Indeed, the court noted that "this case wouldn't be

interesting and wouldn't even be here except for a fairly interesting amount of rent per month."

Relying on *Pacific-Atlantic Trading*, as well as our later decision in *Cukierman*, Pacific Shores contends that we have placed that factor beyond the consideration of the bankruptcy court. *Pacific-Atlantic Trading* held that the contractual rate of rent, rather than the value of the trustee's use of the property, was entitled to administrative priority under § 365(d)(3). 27 F.3d at 405. *Cukierman* extended that holding to the context of a loan disguised as "further rent" under a lease obligation. 265 F.3d at 850. Adhering to the reasoning of *Pacific-Atlantic Trading*, we held that the lessor was entitled to the contractual rate of rent even though the "rent" in question was "arguably completely unrelated to Cukierman's use of the property." *Id.* Taken together, those two cases establish a "bright-line rule" under which the administrative rent owed under § 365(d)(3) "encompass[es] all obligations contained in a bargained-for agreement" regardless of any benefit to the debtor. *Id.* at 851.

That bright-line rule governs the calculation of administrative rent, but it does not render the amount of rent irrelevant to the equitable balancing that a court must perform when deciding whether to approve a motion to reject a lease retroactively. As the district court succinctly explained,

> for purposes of calculating administrative expenses under section 503(b)(1), the fair value of nonresidential leaseholds is irrelevant; in that circumstance, the contract rate governs. But these provisions do not preclude consideration of the amount of rent that would be due in determining whether the balance of equities weighs in favor of retroactive application of rejection.

*At Home Corp.*, 292 B.R. at 203 (citation omitted). We agree with the district court that the bankruptcy court had the discretion to consider both Pacific Shores's motivation in opposing retroactive lease rejection and the amount of rent owing under the contract.

As did the First Circuit in *Thinking Machines*, "we eschew any attempt to spell out the range of circumstances that might justify the use of a bankruptcy court's equitable powers in this fashion." 67 F.3d at 1029 n.9. We likewise eschew any attempt to limit the factors a bankruptcy court may consider when balancing the equities in a particular case. We need not and do not decide whether any one of the factors on which the bankruptcy court relied, standing alone, would justify an exercise of discretion. But in combination those factors supported the court's equitable decision.

## CONCLUSION

We agree with the First Circuit's holding in *Thinking Machines* that a bankruptcy court has discretion to grant a motion to reject a nonresidential lease retroactively. The retroactive date of rejection need not be on or after the date on which the landlord regains possession. In view of those holdings, the only remaining question is whether the bankruptcy court abused its discretion in granting Debtor's motion here. We conclude that it did not.

AFFIRMED.

## APPENDIX C

**UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF CALIFORNIA**

**No C-02-0045 VRW**

**[Filed, March 26, 2003]**

| | |
|---|---|
| In re: AT HOME CORPORATION, a Delaware corporation, Debtor. | ) |
| PACIFIC SHORES DEVELOPMENT, LLC, Appellant, | ) |
| v. | ) |
| AT HOME CORPORATION, Appellee. | ) |

## OPINION

WALKER, United States District Judge.

Appellant Pacific Shores Development, LLC, appeals the decision of the bankruptcy court below, which ordered debtor and appellee At Home Corporation's leases with appellant rejected effective nunc pro tunc to the date appellee filed its

rejection motion. For the reasons detailed herein, the court AFFIRMS the decision below.

I

In February 2000, At Home leased two office buildings located in Redwood City from Pacific Shores. At the time, At Home anticipated that the nonresidential lease space would help accommodate its growth needs. At Home suffered a severe downturn in business, however, and on September 28, 2001, At Home sought Chapter 11 bankruptcy protection. See App (Doc # 12) at 4.

The same day, At Home moved under 11 USC § 365(a) to reject unexpired nonresidential real property leases, including its leases with Pacific Shores for buildings it had never occupied. Id at 1-16. Notice of the motion was provided to Pacific Shores the same day. *Id* at 148. The emergency motion sought rejection to apply retroactively to the date of filing. *Id* at 1-16.

At Home's first day emergency motions hearing was held on October 1, 2001. *Id* at 30. At that hearing, Judge Carlson set the emergency motion concerning rejection of nonresidential leases to be heard on October 9, 2001. Id at 77-78. During this time, At Home did not deliver a formal surrender notice to Pacific Shores. Id at 134. On October 4, 2001, Pacific Shores filed a limited objection; it did not oppose lease rejection but moved to prevent retroactive application. *Id* at 91-100.

At the October 9, 2001, bankruptcy hearing, At Home explained that its decision not to provide formal surrender notice was meant as a precautionary measure to prevent Pacific Shores from claiming over $1,000,000 held in a

construction escrow account as a result of default. Id at 134, 140-41. Moreover, At Home reiterated that it did not occupy the premises in question because construction had not yet been completed; hence, the rent Pacific Shores would have received under the lease would have forced At Home and its shareholders and creditors to pay significant sums for which they had received no commensurate benefit. *Id* at 137. Finally, At Home contended that its rejection motion provided ample notice to Pacific Shores, as of the date the notice was filed, that At Home intended to reject the leases in question and that Pacific Shores suffered no loss of interest from the absence of formal notice of surrender during the time until the motion was heard. *Id* at 139-40, 148.

In opposition, Pacific Shores contended that section 365 does not allow bankruptcy courts to exercise their equitable powers to allow rejection to apply retroactively prior to the date of court approval or prior to the time of formal surrender. Furthermore, because At Home had not provided a formal notice of surrender and was still legally in possession of the premises, Pacific Shores could not re-let the premises to another tenant. In addition, according to Pacific Shores, "debtor must bear the burden of the small delay associated with rejecting the leases." *Id* at 93.

The bankruptcy court determined that this was "a close question" but ultimately sided with At Home and exercised its equitable powers to order that rejection of the leases be applied retroactively to September 28, 2001, the date of filing, rather than October 9, 2001. Ruling from the bench, the court below explained:

> On reviewing the *Thinking Machines* case and interpreting these facts as best I can, I believe this is a case where a nunc pro tunc order is appropriate

under * * * the equitable relief section of Thinking Machines.

And I so determine because of the following facts and circumstances. First, I note that the Debtor moved immediately * * * to reject the lease * * *. I note, second, that the Debtor set this matter for hearing promptly. It wasn't perfect. It wasn't done absolutely as soon as possible, but it was done without any delay. There was a [court] holiday in here. * * * There was neither any deliberate use of a long notice period to keep their options open nor in fact as I can see it any indifference to the timing concerns of the landlord. This is virtually as soon as possible in this particular case.

Third, I note that the Debtor is not in possession of the premises. I think that is a factor that makes it easier for the landlord to re-let and also has some effect on interpreting what the Debtor did. And last, I note that the landlord's opposition was to any nunc pro tunc effect generally without any suggestion here that this process should be speeded up so that they could get - the landlord could get its indefeasible right to re-let the premises more quickly.

I'm going to grant the relief requested by Debtor here because I am convinced that the opposition to this relief is motivated by the landlord's interest in running the administrative rent, and it is not motivated by a - primarily by a concern to get this indisputable right to start re-letting the premises as quickly as possible.

App (Doc # 12) at 153-54.

In addition to the arguments raised at the bankruptcy court hearing, Pacific Shores argues that the court below clearly erred in finding that At Home was not in "possession" of the lease premises because it had not formally surrendered the premises. *Id* at 8.

II

As a preliminary matter, the court considers At Home's late-filed motions to strike portions of its own brief as well as portions of Pacific Shores's reply brief and to oppose Pacific Shores's Request for Judicial Notice. *See* Doc # 19. Pacific Shores opposes these requests. *See* Doc # 21.

Bankruptcy LR 9013-1(e) provides that, except for relevant judicial opinions published after the date the opposition or reply was filed, "once a reply is filed, no additional memoranda, papers or letters shall be filed without prior Court approval." Here, At Home's motion to strike was filed on October 23, 2002, more than five months after Pacific Shores's reply was filed. See Appellant Repl Br (Doc # 14) (filed May 17, 2002). At Home did not seek or obtain court approval for its extraneous filing. Accordingly, the court disregards At Home's motion to strike.

Pacific Shores, in connection with its reply brief, requests judicial notice of two documents: a memorandum concerning one of the leases at issue and excerpts of a transcript of a 1998 hearing in the Bankruptcy Court for the District of Delaware, in which the presiding judge presented his views on circumstances that warrant retroactive relief for nonresidential lease rejection. The court takes judicial notice of the transcript, as part of the public record, but declines to take judicial notice of the memorandum concerning the lease terms as unnecessary.

In its opening brief, At Home had argued in a footnote that because the leases at issue "state that their terms would have commenced as of the date that (1) the Premises were actually occupied by the Debtors or (2) a certificate of occupancy was issued for the Premises, it is questionable whether the Debtors were even entitled to possess * * * the Premises." Appellee Br (Doc # 11) at 5 n2. As Pacific Shores points out, however, it is clear that At Home did not raise this argument before the bankruptcy court and, accordingly, that the bankruptcy court did not consider it. See Appellant Repl Br (Doc # 14), at 6. Hence, judicial notice of this document is unnecessary.

III

Under section 365(a), a debtor in possession "may assume or reject any executory contract or unexpired lease of the debtor" upon approval of the court. 11 USC § 365(a). Bankruptcy courts generally approve rejection if the debtor demonstrates that the rejection will benefit the estate under a "business judgment" test. *See Sharon Steel Corp v National Fuel Gas Distrib Corp*, 872 F2d 36, 39-40 (3d Cir 1989).

Pacific Shores does not attack the bankruptcy court's decision to approve rejection. It appeals only from the portion of the bankruptcy court's order allowing rejection nunc pro tunc to the original date of the rejection motion's filing.

Pacific Shores contends that the bankruptcy court erred in two respects: first by allowing retroactive application of rejection in the absence of formal surrender, and second by abusing its discretion in finding that At Home was entitled to such equitable relief. The first contention raises a question of law which this court reviews de novo. *See In re Lazar*, 83 F3d 306, 308 (9th Cir 1996). The second issue, a bankruptcy

court's exercise of discretion concerning a request for retroactive relief, is reviewed for abuse of discretion. *Thinking Machs.*, 67 F.3d 1021, 1028 (1st Cir 1995). "An abuse of discretion occurs if the district court does not apply the correct law or rests its decision on a clearly erroneous finding of fact." *Forest v Skinner*, 70 F.3d 1084, 1087 (9th Cir 1995).

A

The court first considers de novo the question whether bankruptcy courts may exercise discretion to order rejection of leases retroactively under section 365 if the debtor has not formally surrendered the premises.

Section 365 of the Bankruptcy Code provides in pertinent part:

> (a) * * * The trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.
> * * *
>
> (d) * * * (3) The trustee shall timely perform all the obligations of the debtor * * * arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title. * * *
>
> (4) * * * If the trustee does not assume or reject an unexpired lease of nonresidential real property under which the debtor is the lessee within 60 days after the date of the order for relief, or within such additional

> time as the court, for cause, within such 60-day period, fixes, then such lease is deemed rejected * * *.

11 USC § 365.

The statute on its face does not specifically address whether the bankruptcy court may order rejection to be applied retroactively or whether formal surrender is a condition precedent to rejection thereunder. But by its plain language, the initial decision to assume or reject an executory contract lies with the trustee. *See also In re Arizona Appetito's Stores, Inc*, 893 F.2d 216 at 219 ("The trustee is to assume or to reject, and the court is to approve or disapprove."). "Until such lease is assumed or rejected," the trustee's obligations thereunder continue to accrue. 11 USC § 365(d)(3). The Ninth Circuit has explained that because the trustee's decision is subject to court approval, "rejection of an unexpired lease can be accomplished only by an order of a bankruptcy court." 893 F2d at 219. Nothing in the statute, however, suggests that for purposes of section 365(d)(3), rejection cannot be ordered retroactively to the date the successful rejection motion was filed. Nor does the statute condition accomplishment of rejection on prior formal surrender.

Pacific Shores relies primarily on *In re Arizona Appetito's Stores, Inc*, 893 F2d 216, 219 (9th Cir 1990), *In re Cukierman*, 265 F3d 846 (9th Cir 2001), and *In re Pacific-Atlantic Trading Co*, 27 F3d 401 (9th Cir 1994), to support its view that formal surrender is required for rejection under section 365.

None of these cases, however, address the precise issue at bar: whether a bankruptcy court, upon a successful motion to reject an unexpired lease, may order that rejection to be effective as of the motion filing date, notwithstanding the

debtor's failure to surrender formally the premises. Cf *In Re Thinking Machines Corp.*, 67 F.3d 1021, 1028n4 (1st Cir 1995) (noting that Ninth Circuit has not addressed the issue).

Unlike the case at bar, in *In re Cukierman*, 265 F3d at 846, the debtor sought to *assume* the lease under section 365, but the bankruptcy court denied the motion, thereby effectively rejecting the lease. Id at 848. The Ninth Circuit held that, under that circumstance, the landlord was entitled to administrative rent until the date the lease was effectively rejected. Likewise, in *In re Pacific-Atlantic Trading Co*, 27 F3d at 401-02, the trustee failed timely to take any formal cognizable action regarding the lease at issue and, accordingly, it was deemed effectively rejected upon the passage of 60 days. Hence, these cases do not address whether a debtor's successful motion to reject a lease may be given retroactive effect to the date the motion was filed or whether formal surrender is required for such retroactive effect.

The circumstances of *In re Arizona Appetito's Stores, Inc* are even farther afield. In that case, the debtor attempted to argue that it could, after the statutorily prescribed sixty-day period, reverse course and assume the lease in question. The Ninth Circuit rejected that argument and held that "a lease is deemed rejected with the passage of the sixty-day period, where, as here, the trustee has filed a motion for rejection." 893 F2d at 219. That case also dealt with the operation of the sixty-day period in which debtors may move to reject a nonresidential lease.

Pacific Shores contends that no court has ordered a lease rejection retroactive to a date prior to the date on which the landlord was restored to legal possession. But this is not true. *See In re Thinking Machines Corp*, 67 F3d at 1023 (landlord

moved for immediate possession of premises approximately six weeks after motion to reject lease); *In re New Valley Corporation*, 2000 U.S. Dist. LEXIS 12663, 2000 WL 1251858, **5, 15 (D NJ 2000) (retroactive application of rejection to three months prior to the formal date of surrender). Cf *In re Joseph C Spiess*, 145 BR 597, 599 (Bankr ND Ill 1992) (noting debtor vacated premises but without mention of formal surrender).

While Pacific Shores argues that At Home was required to surrender the premises upon filing the rejection motion, it fails to cite any authority to that effect. The focus of section 365(d) is on rejection, which is accomplished by way of motion and court approval, not on formal surrender. *See In re Arizona Appetito's Stores, Inc*, 893 F2d at 219; 11 USC § 365(d)(1)-(4) (treating rejection as distinct from formal surrender). The cases cited by Pacific Shores discuss surrender as a factor which may weigh in the bankruptcy court's equitable decision to order retroactive relief, but none of them discusses the issue as a distinct legal question or precludes the relief at issue here. See *In re O'Neil Theatres*, Inc, 257 BR 806, 808 (Bankr ED La 2000); *In re New Valley Corp*, 2000 U.S. Dist. LEXIS 12663, 2000 WL 1251858 at *15 (noting that landlord's effective control over premises was one factor used in weighing the equities); *In re Amber's Stores*, Inc, 193 BR 819 (Bankr ND Tex 1996) (relying on *In re Thinking Machines* to conclude that "nothing precludes a bankruptcy court, based on the equities of the case, from approving the trustee's rejection of a non-residential real property lease retroactively to an earlier date); *In re Jamesway Corp*, 179 BR 33, 37 (SDNY 1995) (section 365 "does not state that rejection cannot be applied retroactively, or that there are restrictions as to the manner in which the court can approve rejection"); *In re Joseph Spiess*, 145 BR at 606 (not addressing surrender issue but instead concluding

that "a trustee's rejection of a lease should be retroactive to the date that trustee takes affirmative steps to reject such lease such as serving notice of a motion to reject"). Instead, the absence of formal surrender would appear from the cases recited to be more properly conceptualized as a factor to be considered by a bankruptcy court in weighing the equities of retroactive relief.

Furthermore, notwithstanding the absence of formal surrender, retroactive relief to the motion filing date does not conflict with the purpose of the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub L No 98-353, 98 Stat 333 (1984). Those amendments, which Senator Hatch referred to as the "Shopping Center Bankruptcy Amendments," added the pertinent paragraphs of subsection (d), in order to prevent delay on the part of debtors in choosing whether to assume or reject a nonresidential lease:

> Congress became concerned about the practical consequences of Chapter 11 filings by tenants of shopping centers. It was particularly concerned that mall operators were facing periods of extended vacancies, that would last until such time as the bankruptcy courts would finally decide to take the initiative and force debtors to make a choice whether to assume or reject the leases.

*In re Arizona Appetito's Stores, Inc*, 893 F2d at 220 (quoting *In re Southwest Aircraft Serv*, 831 F2d 848, 849 (9th Cir 1987)).

As Senator Hatch explained at the time of enactment, these provisions were meant to prevent trustees from failing to "make payments due under the lease" "during the time the debtor * * * had not yet decided whether to assume or reject

the lease * * *." 1984 USCCAN at 599. Hence, the legislative history indicates that Congress intended to prevent trustees from profiting from their own indecision and delay in rejecting a lease at the expense of landlords. Nothing contained therein suggests that Congress intended to foreclose the action taken by the bankruptcy court below. In light of the plain language and structure of the statute, as well as its legislative history, the court declines to find that the bankruptcy court erred in ordering retroactive relief in the absence of formal surrender.

Unlike the appeal at bar, the landlords in *Cukierman* and *Pacific-Atlantic Trading Co* did not have effective notice that the debtors did not intend to assume the leases in question. As a result, requiring payment of administrative rent furthered the "intent of Congress to secure for lessors the full amount of rent due during the 60-day period while the trustee determines to accept or reject the lease * * *." *In re Pacific-Atlantic Trading Co*, 27 F3d at 405. Here, however, it is undisputed that At Home provided such notice on the very day it filed for bankruptcy protection.

The bankruptcy court below relied on *In re Thinking Machines Corp*, in which the First Circuit held that "a bankruptcy court, when principles of equity so dictate, may approve a rejection of a nonresidential lease pursuant to section 365(a) retroactive to the motion filing date." 67 F3d at 1028. The First Circuit reasoned that "retroactive approval orders do not contradict § 365(a)(3)" because "while that provision commands the trustee to pay rent at the contract rate until a nonresidential lease is rejected, it does not stipulate that a rejection cannot be made to apply retroactively." Id at 1028. As Pacific Shores points out, First Circuit precedent is not binding on these proceedings, but the court nevertheless finds the First Circuit's reasoning persuasive in this context.

Bankruptcy courts have long possessed the power to exercise equitable powers to further the purposes and goals of the Bankruptcy Code. See *Norwest Bank, Worthington v Ahlers*, 485 U.S. 197, 206, 99 L. Ed. 2d 169, 108 S. Ct. 963 (1988). Bankruptcy courts are "essentially courts of equity, and their proceedings are inherently proceedings in equity." *Pepper v Litton*, 308 U.S. 295, 304, 84 L. Ed. 281, 60 S. Ct. 238 (1939); see also 11 USC § 105(a) (authorizing bankruptcy courts to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Bankruptcy Code). "Particularly in the Chapter 11 context, they may sometimes abandon mechanical solutions in favor of the pliant reins of fairness." *In re Thinking Machines Corp*, 67 F3d at 1028.

"While [section 365(d)(3)] commands the trustee to pay rent at the contract rate until a nonresidential lease is rejected, it does not stipulate that a rejection cannot be made to apply retroactively." 67 F.3d at 1028 n7. Furthermore, "the fact that the bankruptcy court has the power to approve the trustee's rejection of an unexpired nonresidential lease retroactive to the motion filing date has a salutary effect" by "acting as a stimulus to all parties to cooperate in getting the trustee's motion to reject heard and determined at the earliest practicable date." *Id.* By creating an incentive for trustees to determine whether to accept or reject a lease at the earliest possible date, retroactive application of rejection to the date of the motion filing in may promote the goal of the 1984 amendments to the Bankruptcy Code. As discussed, the precise time at which formal surrender was accomplished, if at all prior to the court order, is but one factor the court may consider in ordering retroactive relief.

Pacific Shores argues that it should not have to bear the cost of the inevitable delay between the time At Home filed its

motion and the time the motion was granted by the bankruptcy court. But "all creditors - including landlords - should expect some loss, delay or inconvenience. Whatever the loss may be from the delay between a debtor's rejection and court approval of same would constitute the landlord's cost from doing business with an insolvent tenant - a cost to be borne by the landlord, not the other creditors." *In re Joseph C Spiess*, 145 BR at 605.

In light of the importance of a bankruptcy court's equitable powers to further the goals and objectives of the Bankruptcy Code and the absence of authority removing such equitable discretion in the context of nonresidential lease rejection, the court is unwilling to hold that a bankruptcy court may not provide retroactive relief, in appropriate circumstances, under section 365 to the motion filing date despite the absence of a formal notice of surrender.

B

Alternatively, Pacific Shores contends that the bankruptcy court abused its discretion by relying on a clearly erroneous factual finding that At Home was not in possession of the premises.

Strangely, despite the parties' agreement that no formal surrender notice had been provided, the bankruptcy court noted that "Debtor is not in possession of the premises." App (Doc # 12) at 153. Appellant conjectures that if the bankruptcy court was not referring to legal possession of the premises, which may be surrendered only by formal notice, it was referring instead to the fact that At Home did not occupy the premises. The court agrees with Pacific Shores's alternative explanation and concludes that the bankruptcy court was referring to the fact that At Home did not occupy

the premises since construction was still ongoing for the buildings in question. *See id at 153* (noting that this was "a factor that makes it easier for the landlord to re-let and also has some effect on interpreting what the Debtor did").

But even assuming arguendo that the court below erred in finding that At Home was not in legal possession of the premises, as previously explained, a surrender of legal possession is not required under section 365. Moreover, the existence of other equitable factors, as discussed below, is sufficient for the court to conclude that the bankruptcy court did not abuse its discretion.

Despite At Home's failure to supply a formal notice of surrender, its intention to reject the Pacific Shores leases on the date it filed for bankruptcy protection was unequivocal. The bankruptcy court also found that Pacific Shores did not contend that it was harmed in any way by the lack of formal surrender; Pacific Shores did not deny that At Home did not occupy the premises, which were still being built out, or that it was in fact prevented from re-letting the premises to another tenant in the meantime. Accordingly, it was not clearly erroneous for the bankruptcy court to find that Pacific Shores sought to receive a windfall by opposing the retroactive application of a rejection order and that retroactive application was appropriate in the absence of a formal surrender.

Pacific Shores further argues that the bankruptcy court erred in considering several improper factors, such as "the amount of monthly rent, the speed with which [At Home] acted" and whether Pacific Shores suggested speeding up the process. It was not error, however, for the bankruptcy court to consider these factors in determining whether to exercise its equitable powers. The monetary impact on both At Home and Pacific Shores is relevant to determine the balance of equities.

Similarly, the speed with which each party acted is also a relevant factor. Finally, while Pacific Shores was under no express legal obligation to act affirmatively with respect to At Home's rejection motion, the court, acting in equity, was nevertheless entitled to take into account its actions during the eleven-day period to ascertain the potential impact of its decision on the parties.

The authorities cited by Pacific Shores concern the rent to which landlords are entitled until such time as the leases are rejected. It is true that for purposes of calculating administrative expenses under section 503(b)(1), the fair value of nonresidential leaseholds is irrelevant; in that circumstance, the contract rate governs. *See In re Cukierman*, 265 F3d at 850 (discussing § 365(d)(3) and 503(b)(1)). But these provisions do not preclude consideration of the amount of rent that would be due in determining whether the balance of equities weighs in favor of retroactive application of rejection. Only if the debtor has failed to reject a nonresidential lease pursuant to section 365(d)(3) does the contract rate apply.

The record before the bankruptcy court indicated that (1) At Home moved immediately to notify Pacific Shores that it wished to reject the leases; (2) At Home moved for a prompt hearing on its motion; (3) At Home did not occupy the premises because construction had not yet been completed and (4) Pacific Shores did not ask for formal surrender prior to the hearing and did not contend that it in fact was prevented from re-letting the premises. Based on these factors, the bankruptcy court concluded that Pacific Shores was concerned more with receiving a substantial amount of administrative rent than with obtaining the right to re-let the premises. App (Doc # 12) at 143, 146, 149.

The role of this court is not to reweigh the evidence but solely to determine whether the bankruptcy court's factual findings were clearly erroneous and whether it abused its discretion in ordering retroactive rejection of At Home's nonresidential leases with Pacific Shores. Upon review of the record, the court is not left with a "definite and firm conviction that the court below committed a clear error of judgment in the conclusion it reached upon a weighing of the relevant factors." *In re Carraher*, 971 F2d 327, 328 (9th Cir 1992). Accordingly, the decision of the bankruptcy court below is AFFIRMED.

IV

In sum, the court AFFIRMS the decision of the bankruptcy court below. The clerk is directed to close the file and terminate any pending motions.

IT IS SO ORDERED.

03-26-03

VAUGHN R WALKER
United States District Judge

## APPENDIX D

**UNITED STATES BANKRUPTCY COURT**
**NORTHERN DISTRICT OF CALIFORNIA**
**(SAN FRANCISCO DIVISION)**

**Case No. 01-32495 TC**

[October 9, 2001]

| | |
|---|---|
| In re: | ) |
| | ) |
| AT HOME CORPORATION, | ) |
| a Delaware corporation, et al., | ) |
| Debtor. | ) |
| | ) |

TRANSCRIPT OF PROCEEDINGS

MOTION FOR ORDER AUTHORIZING REJECTION OF UNEXPIRED LEASES OF NON-RESIDENTIAL REAL PROPERTY

BEFORE THE HONORABLE THOMAS E. CARLSON
UNITED STATES BANKRUPTCY JUDGE

[p.40]

THE CLERK: All rise.

THE COURT: Please be seated. Okay. I thank you for an interesting situation.

This case wouldn't be interesting and wouldn't even be here except for a fairly interesting amount of rent per month. I hope I've convinced you that I've read this case carefully and thought about this carefully. I realize that notwithstanding the fact there's only a few days, [p.41] there's a fair amount of money at stake. And on reviewing the *Thinking Machines* case and interpreting these facts as best I can, I believe this is a case where a nunc pro tunc order is appropriate under Section ©, the Equitable Relief Section, of *Thinking Machines*.

And I so determine because of the following facts and circumstances. First, I note that the Debtor moved immediately upon filing for relief -- to reject the lease, rather. I note, second, that the Debtor set this matter for hearing promptly. It wasn't perfect. It wasn't done absolutely as soon as possible, but it was done without any delay. There was a holiday in here. There were a lot of things, going on in the case. There was neither any deliberate use of a long notice period to keep their options open nor in fact as I can see it any indifference to the timing concerns of the landlord. This is virtually as soon as possible in this particular case.

Third, I note that the Debtor is not in possession of the premises. I think that is a factor that makes it easier for the landlord to re-let and also has some effect on interpreting what the Debtor did. And last, I note that the landlord's opposition was to any nunc pro tunc effect generally without any suggestion here that this process should be speeded up so that they could get -- the landlord could get its indefeasible right to re-let the [p. 42] premises more quickly.

I'm going to grant the relief requested by Debtor here because I am convinced that the opposition to this relief is motivated by the landlord's interest in running the administrative rent, and it is not motivated by a – primarily by

a concern to get this indisputable right to start re-letting the premises as quickly as possible.

Now, at the same time, I want to note for anybody who could benefit from this, that this isn't the best practice. This came up at our Judges' Panel, can you reject on the petition date, and I think we all said no, you can try and you can probably get it really soon thereafter, but as I suggested, the thing to do here is to try to run this through as a stipulation. This is what the Debtor should do, and the courts will look upon this as --you know, I look upon this as a close question. If you go through and try to get a stipulation from the landlord, try to go through the U.S. Trustee, and then try to get an ex parte order, upon the stipulation of the U.S. Trustee that nobody else needs to be noticed, that's how you do it. You can do it faster than this, and that's what the Debtor ought to do.

But there are other factors in this case which I've noted that indicate to me that this is also a case where this sort of relief is appropriate. So the Debtor [p. 43] may submit an order rejecting -- having this lease rejected as of the petition date.

MR. BARRON: When would you like that order?

THE COURT: The landlord is -- you should submit the order as soon as you can. The landlord is notified that that order will be nunc pro tunc and they may go--they may start re-letting the premises, that the order is effective as of now, and they are completely free to dispose of the premises as they wish.

MR. BARRON: And I assume you would like the order to address the other objections?

THE COURT: To address the other objections?

MR. BARRON: The objections with the other landlords as–

THE COURT: Well, I think you need -- you may have to -- you're going to have to -- if you're going to deal with all the landlords in one order, you're going to have to have separate provisions regarding those other landlords. Okay?

Okay. Anything else? Thank you.

THE CLERK: All rise.

(Whereupon, the proceedings are concluded at 11:01 a.m.)

## APPENDIX E

### 11 U.S.C. § 105. Power of court

(a) The Court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

### 11 U.S.C. § 365. Executory contracts and unexpired leases

(a) Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or unexpired lease of the debtor.

...

(d)...

(3) The trustee shall timely perform all the obligations of the debtor, except those specified in section 365(b)(2), arising from and after the order for relief under any unexpired lease of nonresidential real property, until such lease is assumed or rejected, notwithstanding section 503(b)(1) of this title. The court may extend, for cause, the time for performance of any such obligation that arises within 60 days after the date

of the order for relief, but the time for performance shall not be extended beyond such 60-day period. This subsection shall not be deemed to affect the trustee's obligations under the provisions of subsection (b) or (f) of this section. Acceptance of any such performance does not constitute waiver or relinquishment of the lessor's rights under such lease, or under this title.

(4) Notwithstanding paragraphs (1) and (2), in a case under any chapter of this title, if the trustee does not assume or reject an unexpired lease of' nonresidential real property under which the debtor is the lessee within 60 days after the date, of the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such lease is deemed rejected, and the trustee shall immediately surrender such nonresidential real property to the lessor.